

**PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA**

**ENERGY DIVISION**

**RESOLUTION E-3850**

**December 4, 2003**

**R E S O L U T I O N**

**Resolution E-3850. Southern California Edison Company requests approval of its investment management agreements with Alliance Capital Management L.P. and State Street Global Advisors.**

**Request Approved.**

**By Advice Letter 1748-E filed on September 22, 2003.**

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**SUMMARY**

This Resolution approves Southern California Edison Company (Edison) Nuclear Facilities Decommissioning Master Trust Committee (Committee) investment management agreements appointing Alliance Capital Management L.P. (Alliance) and State Street Global Advisors (State Street) as domestic equity investment managers of Edison's Qualified and Nonqualified nuclear decommissioning trusts.

**BACKGROUND**

In Order Instituting Investigation No 86, the Commission conducted an extensive investigation, on its own motion, into the recovery of costs of decommissioning nuclear power plants owned by the California utilities. In Decision (D.) 87-05-062, the Commission adopted externally managed trust funds as vehicles for accruing decommissioning funds. In that decision, the Commission also established guidelines for trust agreements.

In response to D.87-05-062, Edison established two trusts; one to hold contributions which qualify for an income tax deduction under Section 468A of Internal Revenue Code (Qualified Trust) and another to hold the remaining

funds (Non-qualified Trust). By Resolution E-3057, dated November 25, 1987, the Commission approved Edison's trust agreements.

As of August 31, 2003, the total market value of the Trusts was \$2.4 billion.

Section 3.01 of both trust agreements provides for the establishment of the Committee. Subject to Commission approval, the Committee is authorized to appoint one or more investment managers to direct investments of all or part of the trusts' assets. To direct the investment of the trusts, the Commission has so far approved the Committee's current investment management agreements for STW Fixed Income Management, RCM Capital Management, Deutsche Asset Management, Pan Angora Asset Management, Black Rock, Alliance, and PIMCP to direct the investment of the Qualified trust; and RCM Capital Management, Pan Agora Asset Management, Black Rock, Deutsche Asset Management, and PIMCO to direct the investment of the Nonqualified Trust.

Edison, in AL 1748-E, and in conformance with D.95-07-055, requests Commission approval of the management agreements to add Alliance and State Street as domestic *equity* (i.e., company shares) investment managers for the Trusts in place of Deutsche Asset Management (Deutsche). Deutsche will no longer provide investment management services to the Trusts.

**Alliance** is currently a *fixed income* (i.e., bonds and commercial paper) investment manager for the Qualified Trust. Edison would like to involve Alliance also in *equity* investment management of the Qualified Trust. **State Street**, on the other hand, is new to the Trusts. In the advice letter, Edison proposes to hire State Street as equity investment manager for both Qualified and Non-qualified Trusts.

The Committee approved retention of Alliance and State Street at its meeting on June 9, 2003. Management agreements with the two were executed on September 12, 2003. Pursuant to Ordering Paragraph 6 of D.95-07-055, executed contracts shall be binding only after Commission approval through the advice letter process. If approved, Alliance and State Street together will assume investment management responsibility for the portions of the Trusts currently managed by Deutsche.

According to Edison, Deutsche was hired in 1994 and in 1996 to direct investment of the Qualified and Nonqualified Trusts, respectively. It has under-

performed the Russell 3000 and S&P 500 benchmarks by 0.20% and 0.10% in the Qualified and Nonqualified Trusts, respectively, since inception. Edison states that as a result of the purchase of Deutsche's index business by the Northern Trust Company, significant organizational changes took place at Deutsche in September of 2002. Because of these changes, the Committee concluded that Deutsche could not sustain some recent improvements in performance and it was in the Trusts' best interest that Deutsche be terminated as a domestic equity investment manager from both Trusts.

Edison conducted a search of 11 reputable investment managers to identify a replacement for Deutsche. The list was narrowed down to four managers with the best credentials and fit with the Trusts for further investigation and interviews, as explained in attachment A to AL 1748-E. After extensive review of the four semifinalists, Alliance and State Street were selected for site visits to inspect their physical plant and operations. Edison staff was impressed by both candidates and recommended to the Committee that Alliance and State Street share the equity management assignment. Management agreements with Alliance and State Street are attached to AL 1748-E as Exhibits 1 and 2.

The proposed agreements between the Committee and Alliance and State Street are substantially the same as the agreements previously approved by the Commission, with the exception of fee schedules, which can be found in Section 6 of the agreement with Alliance (Exhibit 1), and Section 6 of both Qualified and Nonqualified agreements with State Street (Exhibit 2). The fee schedules comply with the guidelines ordered in D.87-05-062 and subsequently in D.95-07-055.

### **NOTICE**

Notice of AL 1748-E was made by publication in the Commission's Daily Calendar. Edison states that a copy of the Advice Letter was mailed and distributed in accordance with Section III-G of General Order 96-A.

### **PROTESTS**

Advice Letter AL 1748-E was not protested.

## **DISCUSSION**

According to Edison, Alliance is a company focusing solely on investment management and research. The firm manages approximately \$380 billion, spread across equity and fixed income assets in the US, international, regional, emerging, and global capital markets. Alliance utilizes an investment management strategy that includes a blend of *growth* and *value* style in a tax-aware manner. Edison maintains that, on a before-tax basis, Alliance's value strategy outperformed the S&P 500 index by 3% annually from 1974-2002; and its growth strategy outperformed the S&P 500 by 2.8% annually from 1978-2002. Alliance's global research staff number well over 300 professionals making it one of the largest independent research firms in the business. Edison states that independent surveys show Alliance as standing apart from its peers on research quality.

State Street, on the other hand, is an industry leader in providing *passive* investment solutions, with nearly \$343 billion of institutional passive equities under management. Passive management is a strategy that seeks to achieve the rate of return of a benchmark index by replicating the composition of the index, but without making management decisions in an attempt to exceed the rate of return of the benchmark index. Edison contends that State Street manages some \$6.7 billion under its *tax-efficient market capture* strategy, which falls under the category of passive management, a strategy that undertakes trading only when necessary to minimize capital gains taxes.

The Energy Division has reviewed Edison's AL 1748-E and concludes that the proposed agreements with Alliance and State Street are in compliance with applicable Commission requirements and that the changes should be beneficial to the ratepayers, as well as shareholders, of Edison. Accordingly, the Energy Division recommends approval of the request.

## **COMMENTS**

This is an uncontested matter in which the resolution grants the relief requested. Accordingly, pursuant to PU Code 311(g)(2), the otherwise applicable 30-day period for public review and comment is being waived.

**FINDINGS**

1. Edison filed AL 1748-E on September 22, 2003 requesting approval of its investment management agreements (Agreements) with Alliance Capital Management L.P. (Alliance) and State Street Global Advisors (State Street).
2. Alliance will be involved in managing the equity and fixed income investments of the Qualified Trust; State Street will take part in managing the equity part of Qualified and Nonqualified Trusts.
3. In D.87-05-062, the Commission required externally managed trust funds to finance the decommissioning of nuclear power plants.
4. D.95-07-055 requires that all Agreements be approved by the Commission through the advice letter process.
5. In its June 9, 2003 meeting, Edison's Nuclear Facilities Decommissioning Master Trust Committee (Committee) approved the Agreements
6. The proposed Agreements by the Committee and Alliance and State Street are substantially the same as the Agreements previously approved by the Commission, with the exception of the fee schedule. The latter is in compliance with the guidelines ordered in D.87-05-062 and D.95-07-055.
7. The proposed Agreements are in compliance with the applicable Commission requirements and should be approved.

**THEREFORE IT IS ORDERED THAT:**

1. Southern California Edison Company's Advice Letter 1748-E is approved.

This resolution is effective today.

I certify that the foregoing resolution was duly introduced, passed and adopted at a conference of the Public Utilities Commission of the State of California held on December 4, 2003; the following Commissioners voting favorably thereon:

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WILLIAM AHERN  
Executive Director

MICHAEL R. PEEVEY  
President  
CARL W. WOOD  
GEOFFREY F. BROWN  
SUSAN P. KENNEDY  
Commissioners

Commissioner Loretta M. Lynch  
being necessarily absent did not  
participate.